NO. 22400

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

CHARLES H. LUNDQUIST,

Appellant,

vs.

JOE TURNER,

Appellee.

BRIEF OF APPELLEE

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

RICHARD H. LEVIN
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Attorney for Appellee,
Joe Turner.

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BRIEF OF APPELLEE

THE FACTS

The following facts are undisputed:

1. JOE TURNER was one of fifteen individuals who either advanced funds to or cancelled an indebtedness of UNITED STATES CHEMICAL MILLING CORPORATION (U.S.C.M.), in return for subordinated, convertible debentures.

2. JOE TURNER received $125,000.00 of debentures (under 10 percent) in return for $125,000.00 cash.

3. Another of the individuals who advanced funds to U.S.C.M. in return for such debentures was counter claimant, CHARLES H. LUNDQUIST. Mr. Lundquist received $420,000.00 of debentures in return for $120,000.00 cash and the cancellation of a $300,000.00 indebtedness owed by the Corporation to Lundquist

(see Transcript, Vol. 2, pp. 113-114).

4. JOE TURNER was never an officer or director of U.S.C.M. (Tran., Vol. 2, pp. 114-115).

5. At the time of the issuance of the debentures, and for many years prior thereto, CHARLES H. LUNDQUIST was president and a member of the board of directors of U.S.C.M. (Tran., Vol. 2, pp. 123-124).

5. One of the documents signed by JOE TURNER contained a recital that the note he was acquiring was being acquired and would be taken and received by him for private, personal investment for his own account, with no intention of reselling or otherwise distributing.

6. JOE TURNER pledged the $125,000.00 of debentures issued to him to two Oklahoma banks, which financed his acquisition of the debentures.

7. At or prior to the time of issuance of the debentures, U.S.C.M. received knowledge that Mr. Turner's acquisition of the debentures was being financed by the Oklahoma banks and that the debenture was being pledged by Mr. Turner to the Oklahoma banks. U.S.C.M. had knowledge of the above by reason of the fact that the $125,000.00 was paid to U.S.C.M. directly by the Oklahoma banks and U.S.C.M. delivered the $125,000.00 debenture directly to the Oklahoma banks. (Tran., Vol. 2, p. 109 and 187-188, and Findings of Fact 4, 5, and 6 in Tran., Vol. 1, p. 113).

8. The debenture was only part of the assets which Mr. Turner pledged to the Oklahoma banks as security for the payment

of the loan which enabled Mr. Turner to purchase the debenture (Finding 5).

9. Thereafter, Mr. Turner repaid the Oklahoma banks the $125,000.00 which he had borrowed to finance purchase of the debenture and the debenture was returned to Mr. Turner by the banks. (Tran., Vol. 2, p. 189. See also Finding 7).

10. $25,000.00 worth of the $125,000.00 debenture was acquired by Mr. Turner pursuant to an oral understanding with GLEN R. ROLAND, who was an officer of U.S.C.M., that at some future date Mr. Turner would transfer said $25,000.00 worth of the debenture to Mr. Roland in consideration for the receipt by Mr. Turner of $25,000.00 from Mr. Roland (Finding 2).

11. The year following the issuance of the debentures, Mr. Roland did pay Mr. Turner the $25,000.00, without interest (Finding 3).

12. The $25,000.00 worth of the debentures was never transferred by Mr. Turner to Mr. Roland because sometime after the debentures were issued, it became apparent that U.S.C.M. was in serious financial difficulty and that the debentures would be worthless (Tran., Vol. 2, p. 59 and pp. 189-190).

Although the above facts are not in dispute, the inferences to be drawn therefrom are in dispute.

THE ISSUES

Furthermore, the following questions, among others, are in dispute:

1. Did Mr. Turner's conduct constitute a violation of his agreement with U.S.C.M.?

2. Did Mr. Turner's conduct constitute a violation of any Federal Securities Regulation?

3. If Mr. Turner's conduct did constitute a violation of his agreement with U.S.C.M. or constituted a violation of a Federal Securities Regulation, does CHARLES H. LUNDQUIST have a possible claim for damages against Mr. Turner?

4. If CHARLES H. LUNDQUIST has a possible claim against Mr. Turner, has Mr. Lundquist proved:

A. That he acted in reliance upon the above mentioned recital?

B. That his reliance was justified?

C. That the subject matter of the recital was material?

D. That Mr. Turner's breach of the recital, if any, was a material breach?

INTRODUCTORY ANALYSIS

The gist of counter claimant's grievance is that JOE TURNER pledged his debenture to two Oklahoma banks and that JOE TURNER agreed to let GLEN R. ROLAND receive, at some future

date, $25,000.00 worth of the $125,000.00 debenture which Mr. Turner received.

It is our contention that since there never was an actual transfer of the $25,000.00 worth of debenture to Mr. Roland, that Mr. Turner's informal agreement to transfer that amount of the debenture to Mr. Roland did not constitute a sale to Mr. Roland and, therefore, is of no legal significance. We further contend that Mr. Turner's pledge of the $125,000.00 debenture to the two Oklahoma banks was not a sale or distribution of the debenture as those terms were used in the recital.

However, even assuming that it could be held that Mr. Turner's agreement with Mr. Roland or that his pledge of the debenture to the Oklahoma banks placed Mr. Turner in a technical violation of the terms of the recital, any such purported violation would not give Charles H. Lundquist any claim against Joe Turner.

Of what real significance is it that Joe Turner informally agreed to let Mr. Roland have $25,000.00 worth of the debentures upon payment by Mr. Roland of that sum at some future date? Mr. Roland was an officer of U.S.C.M. But Charles H. Lundquist was president of U.S.C.M., and Charles H. Lundquist was not the only officer or former officer or director of U.S.C.M. to participate in the debenture issuance. Hence, what difference would it have made if there were sixteen debenture holders instead of fifteen?

It should be obvious that the purpose of the recital that the debenture holders were acquiring their debentures for their own

private investment was to attempt to preserve the private offering exemption. Obviously, the recital was an attempt by U.S.C.M. to limit the likelihood of a public distribution of the debentures by the holders, or to in some way immunize U.S.C.M. from liability if any of the holders did publicly distribute the debentures, thereby endangering the private offering exemption.

But surely it cannot be contended that a transfer of $25,000.00 worth of debentures to Glen R. Roland would destroy the private offering exemption. Since any agreement by Mr. Turner to transfer some of his interest in the debenture to Mr. Roland would not destroy the private offering exemption, Mr. Turner's conduct did not invalidate the debentures, contrary to the unsupported assertion by Mr. Lundquist's counsel that Mr. Turner "destroyed" the exemption from registration.

Similarly, the fact that Mr. Turner pledged the debenture as security for the payment of the loan and thereafter paid off the loan and received back the debenture likewise did not destroy the private offering exemption. This being the case, the validity of the debentures was not affected by Mr. Turner's pledge. And, in any event, the validity of Charles H. Lundquist's debentures certainly was not affected by Mr. Turner's pledge.

Thus, what Mr. Lundquist's case boils down to is the contention that conduct by Mr. Turner, which may or may not have constituted a technical violation of the recital that the debentures were being acquired for private investment, enables Mr. Lundquist to obtain relief against Mr. Turner. Yet Mr. Lundquist cannot show

that the debentures were invalidated by reason of Mr. Turner's conduct, or that Mr. Lundquist's debenture was invalidated by reason of Mr. Turner's conduct.

Further, even if the debentures were invalidated by Mr. Turner's conduct (and we emphatically deny that they were) we fail to see how Mr. Lundquist (as distinguished from U.S.C.M.) would have any claim against Mr. Turner in any event.

THE CASES DO NOT HOLD THAT CASES SIMILAR TO TURNER'S VIOLATE RULE 10 (b) - 5

Commencing at p. 32 of his opening brief, counterclaimant makes the totally inaccurate assertion that "a number of cases have held that conduct similar to Turner's has constituted a violation of Section 10 (b) and/or Rule 10 (b)-5."

The first case cited in support of this erroneous statement is Kardon v. National Gypsum Co., 69 F.Supp. 512 (E.D. Penn. 1946). Counter claimant asserts that the case involved purchasers of stock who failed to disclose a secret agreement entered into between themselves and third parties. In fact, what the complaint alleged in that case was that defendants falsely represented to plaintiffs that no negotiations were pending for the sale of the assets of the corporation, and that the plaintiffs sold their stock in the corporation to defendants for far less than the true value of the stock. The complaint also alleged that defendants engaged in various acts of fraud which operated to induce the plaintiffs to sell

their stock. Hence, it is apparent that what the plaintiffs sought to prove in that case was that the corporation's agreement to sell its assets increased the value of the corporation's stock and that because the agreement was not disclosed to plaintiffs, they sold their stock in the corporation for far less than fair value. We fail to see how the facts of that case are even remotely similar to those of the instant case. Kardon involved the common situation of a buyer of stock failing to disclose to the seller facts that had an effect upon the worth of the corporation whose stock buyer was purchasing.

The next case cited by counter claimant is Stevens v. Vowell, 343 F. 2d 374 (10th Cir. 1965). Counter claimant characterizes that case as involving a situation where "the plaintiff had been told by the defendants that the money he paid for certain securities would be used for specified purposes only."

The facts of Stevens, as set forth in the opinion of the Court, were as follows:

> "Stevens and Moad had represented to Vowell that the entire amount of his investment ($20,000.00) would be used for the construction of the Archery Lanes in Utah. The evidence further discloses that Worldwide had received approximately $400,000.00 from investors such as Vowell and it had built no Archery Lanes in any locality."

In other words, Vowell was one of many investors who had invested large sums of money in reliance on the representation that the money would be used to build archery lanes, whereas in fact

the promoters siphoned off the funds for their own purposes. Surely that case is not remotely similar on its facts to the instant case.

The next case cited by counter claimant on behalf of his erroneous assertion that conduct similar to Turner's has been held to violate Rule 10 (b)-5 is Ellis v. Carter, 291 F. 2d 270 (9th Cir. 1961). In that case it was alleged that Carter sold 10,000 shares of Republic stock to Ellis at $10.00 a share, at a time when the market price of the stock was $8.50 a share, and that Ellis in buying was relying on the representation that the stock carried with it a voice in the management of the company. According to the allegations of plaintiff, defendants thereafter gained control of the corporation and excluded plaintiff Ellis from having any voice in the management.

This writer fails to see how a case involving a false representation by the seller of stock that the buyer would have a voice in management of the corporation is even remotely similar to the instant case.

The next case cited by counter claimant is M. L. Lee & Co. v. American Cardboard & Packaging Corp., 36 F. R. D. 27 (E. D. Penn. 1964). Counter claimant asserts that "the fraud in that case consisted of a violation of certain contractual provisions, just as the fraud in the instant case is alleged to be in part Turner's violation of his agreement not to transfer the securities."

Let us, however, examine the exact nature of the contractual provisions that were alleged to have been violated in that case. The

case involved a counterclaim by a corporation and its shareholders against plaintiff underwriters, alleging that in reliance upon an agreement by the underwriters to handle the proposed public offering of the corporation's stock, the corporation spent a great deal of money in anticipation of going through with the public offering, but that the underwriters for no explained reason refused to go ahead with the underwriting. This writer fails to see how the facts of that case are even remotely similar to those of the instant case.

The next case cited by counter claimant is Glickman v. Schweickert & Co., 242 F.Supp. 670 (S.D. N.Y. 1965). Counter claimant characterizes that case as one where "the court held that misrepresentations as to the financing of a purchase of securities were actionable."

But let us examine the facts of Glickman. The case involved whether or not motions to dismiss should be granted. Count 1 alleged that to induce plaintiff to buy more stock than margin requirements permitted, defendant's security broker advised plaintiff to factor the stock to First Discount Corporation. Discount Corporation wrongfully converted and sold the stock and thereafter became insolvent. Thus, it should be noted at the outset that the wrongful conduct was a security broker's attempt to evade the margin requirements. With respect to said Count 1, the court said:

> "Thus the only harm which Section 7 (c) of the 1934 Act was designed, generally, to prevent was that which might befall an investor should he

'spread himself too thin' and should the market fall, resulting either in the loss of pledged security or subjection to suit for inability to pay back loans ... conversion of the pledged stock by the financing institution, however, was not the type of risk covered by Section 7 (c)."

The Court, therefore, dismissed Count I.

Count 4 contained an allegation that defendant misrepresented that the means of financing that it recommended was usual, proper and involved no more risk than the usual margin transaction. Count 4 contained the further allegation that defendant security broker had knowledge that First Discount Corporation was unstable and engaged in questionable financial operations, but that it did not disclose these facts to plaintiff.

We fail to see how Glickman, which involved allegations of a security broker's misrepresentation and evasion of the margin requirements, is similar to the conduct which counter claimant complains of in this action.

And the final case cited by counter claimant in connection with his unsupported assertion that conduct similar to Turner's has been held to violate Rule 10 (b)-5 is Keers and Co. v. American Steel and Pump Corp., 234 F. Supp. 201 (S. D. N. Y. 1964). In that case the court dismissed the complaint on the ground that there was no federal jurisdiction. We fail to see how either the facts or the ruling in that case in any way assist counter claimant.

TURNER DID NOT VIOLATE ANY PROVISIONS OF THE SECURITIES ACT OF 1933

Counter claimant's second contention is that Turner violated various provisions of the Securities Act of 1933, thereby giving rise to a cause of action under Section 10 (b)-5 of the Securities Exchange Act of 1934 (Counter claimant's opening brief, pp. 36-40).

The specific contention advanced by counterclaimant in that portion of his brief is that Turner became an "underwriter" under the terms of Section 4 (1) of the Securities Act of 1933, thereby taking the debenture issue out of the private offering exemption.

It is true that an "underwriter" as defined in Section 2 (11) of the 1933 Act, is a person who has purchased from an issuer with a view to distribution of securities.

Counter claimant asserts that Mr. Turner's pledge of his debentures (along with other assets) to the Oklahoma banks made Mr. Turner an underwriter. In support of this contention, several cases are relied on. The first is S.E.C. v. Guild Films Co., 279 F.2d 485 (2nd Cir. 1963). We fail to see how that case assists counter claimant.

The Guild Films case involved a pledge of stock under circumstances where it was obvious at the time of the pledge that the pledgor would default under his loan and that the pledgee would have to sell the pledged stock to the public. The holding in the case was merely that before making a public offering of the pledged

stock, the pledgee would have to comply with federal registration laws. We agree with the rationale implicit in the Guild Films case that a distribution to the public cannot be exempted from the registration requirements by the subterfuge of a sale of stock to one person (thereby seeking to come within the private offering exemption), under circumstances whereby it is intended that the purchaser pledge the stock, and default on the debt, thereby enabling the pledgee to make a public offering of the stock. Such a subterfuge for the purpose of evading the registration requirements certainly cannot be condoned. However, it should be apparent that such a situation has no application to this case. There was no public distribution of the pledged debentures by the Oklahoma banks. Nor was there even any default by Turner in repayment of the loan for which the debentures were, along with other assets, pledged as security. In fact, the record shows that Turner repaid the loan and that the debentures were thereafter returned to him.

The next authority cited by counter claimant is SEC Release No. 33-4552 (1962), C. C. H. Federal Securities Law Reporter, para. 2771, to the effect that in determining whether a transaction comes within the private offering exemption, whether a transaction is one not involving any public offering is essentially a question of fact.

In the instant case the Court heard all of the evidence relative to the issue of liability, and after hearing all of the evidence on that issue the court made findings of fact 3, 4, 5, 6, 7 and 11 (Tran., Vol. 1, pp. 113-114).

Summarized, these findings are as follows:

At the time of the purchase of the debentures Turner had agreed to thereafter transfer $25,000.00 interest in said debentures to Glen R. Roland, an officer of U.S.C.M.;

That subsequent thereto plaintiff did receive $25,000.00 from Mr. Roland; that the $125,000.00 used by Turner to purchase the debentures was obtained by a loan to Turner from two Oklahoma banks;

That as security for the repayment of said sum Joe Turner pledged said debenture and other assets to two Oklahoma banks;

That said debenture was transmitted by U.S.C.M. directly to said Oklahoma banks;

That thereafter Joe Turner repaid said banks all sums owing as a result of said loan and said debenture was returned to Joe Turner;

That Joe Turner in acting as above described was not an issuer or underwriter;

And that in acting as above described Joe Turner did not make a public offering of the aforesaid debenture and did not make an offering to the public of the aforesaid debenture.

Counter claimant concedes in his brief that the question is one of fact. The finding of fact was that there was no public offering by Turner. Unless counter claimant can show that this finding was unsupported by substantial evidence, or was an abuse of discretion, that finding must be sustained on appeal. Counter claimant failed to present to this Court, and failed to present to

he trial court, any decisions of any Court, appellate or trial, to he effect that in cases involving conduct truly similar to the conduct n which Mr. Turner engaged, the Courts have held that a pledge constituted a public offering.

The next case relied on by counter claimant is In the Matter of Skiatron Electronics and Television Corp., 40 SEC 236 (1960). Counter claimant characterized that case as involving a holding that "a certain sale and pledge transaction was in violation of Section 5 of the Securities Act of 1933". Counter claimant neglects, however, to state exactly what that certain sale and pledge were.

Now let us examine exactly what that "certain sale and pledge transaction" was. In Skiatron the person to whom stock was issued had a pattern of immediately pledging the stock as collateral for loans, defaulting on the loans shortly thereafter, and thereby permitting the pledgee to sell the pledged stock to the public. In that case hundreds of thousands of shares of stock had been sold to the public by various pledgees. The Court held that in those circumstances, sale of the pledged stock without registration violated the Securities Act.

Does counter claimant seriously contend that Joe Turner's pledge of a debenture to two Oklahoma banks, thereafter paying off the loan and reacquiring the debenture, is even remotely analogous to the conduct in Skiatron? It is apparent that in Skiatron the sale to an individual was merely a subterfuge by which a public distribution of stock was effected without registration. That was hardly the situation in the instant case.

The next case cited by counter claimant is SEC v. Mono-Kearsarge Consolidated Mining Co., 167 F. Supp. 248 (D. C. Utah 1958).

It is true that said case indicates that an underwriter is one who purchases with a view to distribution. But the question is, what constitutes a distribution? After citing that case, counter claimant asserts that "It is clear, therefore, from the foregoing that Turner was a statutory underwriter within the meaning of the foregoing rule because he purchased his stock from the issuer company with the intention of immediately distributing and selling the same to Roland." However, counter claimant gets no support for that erroneous statement from the above Mono-Kearsage case. That case involved, in the language of the opinion of the Court, "the transfer to Boren of the 962,000 share block ... Boren intended to effect a public distribution ... there was a public offering."

Thus, said case constituted in effect a holding that one who acquires 962,000 shares of stock intending to publicly distribute them is an underwriter. However, that is a far cry from agreeing to transfer a portion of a debenture to one individual or pledging a debenture to two banks as security for a loan which is then paid off, enabling the debenture to be returned to the purchaser. In short, we submit that a "distribution" so as to make one an underwriter, is a public offering of the securities, and not the kind of transfer that occurred in this case. (See our discussion of this later in our brief.)

The next case cited by counter claimant is SEC v. Bond and Share Corp., 229 F. Supp. 88 (D. C. Okla. 1963). That case merely stands for the proposition that an individual who obtains unregistered stock in a corporation for an issuer with a view to distribution thereof, is an underwriter. However, the question is, what constitutes a distribution as that term is used in the Act? It does appear that one who effects a "distribution" as that term is used in the Act, may be an underwriter. But the question which counter claimant neglects to even attempt to answer is, what constitutes a distribution? Certainly SEC v. Bond and Share Corp. is not authority for the proposition that the kind of conduct in which Joe Turner engaged is a distribution as that term is used in the Act. For in that case 613,650 shares of stock were sold to the public through dealers around the country. Does counter claimant mean to contend that Joe Turner's conduct is even remotely similar to sale of 613,650 shares of stock through dealers to the public?

The next case cited by counter claimant is SEC v. Culpepper, 270 F. 2d 241 (Cir. 1959). Counter claimant does not indicate the purported holding of that case or its facts or how that case is in any way relevant to the instant one. In that case there were thirteen defendants. The three appellants had effected a public distribution of 343,495 unregistered shares. Another defendant had sold at least 710,623 shares to brokers and dealers who resold to the public. Does counter claimant mean to contend that Joe Turner's conduct is remotely similar to the sale to the public, through brokers and dealers, of in excess of 1,000,000

shares of stock?

The final case cited by counter claimant in this section of his brief is Fischman v. Raytheon Mfg. Co., 188 F. 2d 783 (2nd Cir. 1951).

Counter claimant characterizes that case as involving plaintiffs who have been induced to buy stock by reason of misstatements in a prospectus. However, counter claimant fails to state the nature of those alleged misstatements. That case on its facts has no similarity with the instant case.

JOE TURNER'S CONDUCT DID NOT DESTROY THE PRIVATE OFFERING EXEMPTION

The recital signed by Turner, which might be called a letter of investment intent, was not a material factor in the transaction. And any non-compliance by Turner with the terms of the recital (we deny that there was any non-compliance) was insubstantial and therefore not material. This cannot be over-emphasized. Unless Turner's conduct destroyed the private offering exemption, the validity of the debentures could not possibly have been affected by Turner's conduct.

And there is no possibility that the private offering exemption was destroyed unless Turner's conduct made him an underwriter. But Turner did not become an underwriter because he made no public offering of his debenture.

As stated in 72 Harvard Law Review, at p. 784:

"Section 2 (11) of the Securities Act defines an 'underwriter' as a person who purchases 'from an issuer with a view to ... the distribution of any security, or participates in, any such undertaking ...' While 'distribution' is not defined in the act, it is clear that it is equivalent to participation in a public offering."

Since it is obvious that plaintiff Joe Turner's agreement to transfer a portion of the debenture to Roland and his pledge to his two Oklahoma banks was not a public offering, plaintiff was not an underwriter.

Since he was not an underwriter, the debenture issue was not required to be registered under Federal Securities Law. Hence, Turner's conduct in no way affected the validity of the debenture issue.

Further, even if the private offering exemption had been destroyed (it wasn't) we fail to see how anyone other than the issuer would have any claim against Mr. Turner.

THE MATERIALITY OF JOE TURNER'S REPRESENTATION WAS DECIDED BY THE TRIAL COURT

Contrary to the assertion appearing in counter claimant's brief (p. 30), there is no testimony that Mr. Lundquist relied on Mr. Turner's representations or that he would not have purchased the debentures had he known of the agreements with Roland and the

Oklahoma banks. All that Mr. Lundquist testified was that he went ahead with the debenture issuance in reliance on its validity.

Further, even if Mr. Lundquist had testified as counter claimant asserts in his brief, the trial court was free to disregard his testimony. The testimony of a party witness does not have to be accepted by the trier of fact. This should be especially so in this case because Mr. Turner's debenture went directly to the Oklahoma banks from U.S.C.M. Lundquist, as president of U.S.C.M., must therefore have known of the pledge. In any event, such knowledge could have been inferred by the trial court.

But even if Lundquist had no knowledge of Turner's intention, it was for the trial court to decide whether Lundquist would have backed out of the deal if he had known of Turner's intention.

In this connection we think the following language appearing in Ross v. Licht, 263 F.Supp. 395 (S.D. N.Y. 1967), at 408-409 is appropriate in this case:

> " . . . the identity of the purchasers from plaintiffs does not seem to me to be a material fact . . . I do not believe plaintiffs cared who bought their shares, whether Charles himself or someone else."

We submit that Lundquist did not care what Turner might do with his debenture, so long as Turner's conduct would not destroy the private offering exemption.

However, even if Lundquist did care about whether or not Turner intended to pledge his debenture to the banks or to transfer

part of the debenture to Roland, these matters were immaterial. Lundquist might have gone through with the debenture issuance in reliance on a statement by Turner that the moon is made of cheese. And if the moon is not made of cheese, would Lundquist have a claim against Turner? The answer is clearly no. That representation would have been immaterial. No reasonable man would have bought the debenture because of the statement that the moon is made of cheese. Likewise, no reasonable man would have refused to buy the debenture if it had been known that Turner would pledge his debenture or might have an oral agreement to transfer an interest in it to one other person.

As stated in List v. Fashion Park, Inc., 340 F. 2d 457 (2nd Cir., 1965), at 462:

> "... thus, to the requirement that the individual plaintiff must have acted upon the fact misrepresented is added the parallel requirement that a reasonable man, would also have acted upon the fact misrepresented."

A further discussion of the materiality requirement in Rule 10 (b)-5 actions is set out at pp. 462-463 of the List opinion.

See also Rogen v. Slikon Corp., 361 F. 2d 260 (1st Cir., 1966) at 266 and Kohler v. Kohler Co., 319 F. 2d 634 (9th Cir., 1963) at 642 which describe as material those facts "which in reasonable and objective contemplation might affect the value of the corporation's stock or securities."

The finding of the trial court (No. 9) was that Turner made no material misstatements. This finding should be upheld by this Appellate Court.

CONDITIONS ON SALE IMPOSED BY CALIFORNIA COMMISSIONER OF CORPORATIONS

In his brief, counter claimant seems to say that Turner's conduct violated the terms of the California Corporation Commissioner's permit, thereby giving Lundquist a claim against Turner.

Assuming only for the purposes of this brief that there may have been a violation of California Corporation law, the question is whether or not counter claimant Lundquist has any claim against plaintiff based on such an alleged violation.

Under California Corporations Code §26101, presumably the California Commissioner of Corporations might have sued to enjoin plaintiff from pledging the debenture. Further, if a pledge of the debenture without the consent of the Corporation Commissioner violated the terms of the permit, Turner might have sued his pledgee for a declaration that the pledge be declared invalid because the pledgee did not obtain the consent of the California Commissioner of Corporations. But how does this right that plaintiff Turner might have to obtain a declaration that the pledge was invalid give counter claimant Lundquist any rights against plaintiff, or anyone else?

The basic question remains, what effect would a violation

y plaintiff have on the issuance by U.S.C.M. of debentures to Lundquist? Although the contention has not been clearly articulated by counter claimant, apparently it is his contention that he has been damaged by reason of the acts of plaintiff because the issuance of debentures to counter claimant somehow would be tainted by any violation of the terms of the California permit by plaintiff.

In the case of Kent v. Kent, 6 Cal. App. 2d 488 at 492-493, the contention was made that since some of the shares of stock were issued in violation of the terms of the permit, that all of the stock issued was void. The Court stated:

> "There is no apparent reason why the issue of some shares in violation of the statute should render void other shares ... the section is clearly limited to the single effect of declaring void those shares not issued in accordance with the required permit."

Even if we were to assume that plaintiff's apparent agreement to transfer a portion of the debenture to Roland violated the terms of the permit, then at worst, that portion of the debenture which Mr. Turner had agreed to transfer to Mr. Roland would be void or at least voidable. But what has this to do with Lundquist's debenture or with the rights of counter claimant Lundquist?

And if a pledge of the stock would violate the terms of the permit, this might give plaintiff some rights against the pledgee for not obtaining a consent or possibly might have given the pledgee some rights against Turner. And if we were to further assume

hat the pledgee thereafter sold the debenture without obtaining consent from the California Corporation Commissioner, that he purchasers of the debenture might have some right against the pledgee for selling the debenture without obtaining the consent of he California Corporation Commissioner. But again, the question arises: What has this to do with counter claimant Lundquist or with his debenture?

In conclusion, we submit that any alleged violation of the California Corporation law by Turner might possibly affect his relationship with Mr. Roland or with the pledgee, or with persons who might subsequently purchase the pledged debenture at a foreclosure sale, but that all this certainly has nothing to do with counter claimant Lundquist and gives him no rights against plaintiff.

CONCLUSION

1. Turner did not violate his investment recitals.

2. Even if he did, the violation was unsubstantial.

3. Since Turner's conduct did not destroy the private offering exemption, there isn't even a possibility that Lundquist was damaged.

4. Lundquist did not prove reliance on Turner's investment recitals.

5. The investment recitals were immaterial except insofar as they were designed to prevent Turner from participating in a public offering. Turner did not make a public offering of his

ebenture. Therefore, to the extent that Turner's recitals were of
iaterial facts, Turner did not violate the recitals.

How counter claimant can blame his loss on plaintiff is
eyond this writer's imagination. The debentures became worth-
ess because the corporation went bankrupt. Counter claimant was
ie president of the corporation and he knows very well why the
orporation went bankrupt. It was the business failure of the
orporation which counter claimant headed that caused counter
laimant's loss.

If anyone has a claim as a result of the debenture issuance,
is Joe Turner who has a claim against Charles H. Lundquist for
raudulently concealing the corporation's financial condition in
rder to induce Turner to loan Lundquist's corporation $125,000.00.
egrettably, Mr. Turner has lost his case against Mr. Lundquist,
ut only on the basis of the statute of limitations.

It might also be mentioned that Lundquist's purported counter-
laim is also barred by the Statute of Limitations. However, since
ie trial court found that Lundquist couldn't prove his case, the
rial court never got around to ruling on that, and other defenses
vailable to Turner.

Respectfully submitted,

RICHARD H. LEVIN

Attorney for Appellee
Joe Turner

CERTIFICATE

I certify that, in connection with the preparation of this rief, I have examined Rules 18, 19 and 39 of the United States ourt of Appeals for the Ninth Circuit, and that, in my opinion, ıe foregoing brief is in full compliance with those rules.

/s/ Richard H. Levin

RICHARD H. LEVIN